

FORM NO. 241  
1 FEB 55

**REPLACES FORM 36-8  
WHICH MAY BE USED.**

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(47)



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11 August 1982

MEMORANDUM FOR THE RECORD

SUBJECT: Briefing Presented to the Senate Foreign Relations Committee (SFRC), on the Soviet Economy and Its Dependence on the West

1. The attached classified briefing was presented today at the behest of the SFRC (Attachment A). In Senator Percy's absence, Senator Lugar and Senator Mathias took turns in the chair. Also present were Senators Glenn, Tsongas, Pressler, and Boschwitz.

2. On 12 and 13 August the SFRC will hold open hearings consisting of four panels of public witnesses, mostly from the academic community (Attachment B). The open hearings will focus on the issues of:

- a. measure of the importance to the Soviet economy of trade with the West.
- b. the issue of economic and political leverage, and
- c. implications for the alliance and for US business.



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Deputy Director  
Soviet Analysis

Attachments:  
As Stated

UNCLASSIFIED UPON REMOVAL  
OF ATTACHMENTS



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*Neil Hunt*

28 July 1982

ATTACHMENT A

MEMORANDUM FOR: [REDACTED] D/SOVA  
 FROM : [REDACTED]  
 DDI/Congressional Support Office. [REDACTED]  
 SUBJECT : Congressional Briefing Request

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BRIEFING DATE : Wednesday, Aug 11, 1982

COMMITTEE: Senate Foreign Relations Committee,  
 Chaired by Sen. Percy

REQUEST : The SFRC will be holding a series of open  
 hearings on the Soviet economy which will consist of four panels  
 of public, not administration, witnesses, on Thursday and Friday,  
 Aug. 5 and 6.

The committee would like a classified briefing from CIA on  
 the following:

1. A brief forecast highlighting Soviet economy through the  
 1980s, i.e., a summary and outlook on the future of Soviet  
 growth rates, agricultural import, labor supply, etc.
2. The degree of Soviet dependence on the West in general  
 (to include Japan), and US unilateral economic leverage  
 possibilities over the Soviets.
3. Soviet alternatives to the use of Western and US  
 unilateral economic leverage, i.e., will the Soviets be  
 forced to make military tradeoffs in the event of  
 continued/increased economic pressure from the US/West?

Diana Smith would like to speak with the main briefer by  
 telephone prior to this briefing to clarify any questions that  
 our people may have.

CIA briefing to be non-codeword if possible--personal  
 staffers also want to attend and do not have codeword clearance.

DEPARTURE TIME: 9:30 a.m. BRIEFING TIME: 10:30 a.m.  
 Plaza Entrance

ESCORT OFFICER: Cathy Slatinshek, Legislative Liaison Division

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Panel I:

Professor Herb Levine  
Department of Economics  
University of Pennsylvania

Professor Vladimir G. Treml  
Department of Economics  
Duke University

I. Topic: Measurement of the  
Importance of Soviet  
Trade

Panel II:

Dr. Charles Wolf  
Dean, Rand Graduate Institute  
The Rand Corporation

Mr. Kempton Jenkins  
Vice President, Governmental Affairs  
ARMCO

Mr. Ed Hewett  
Senior Fellow  
Brookings Institution

II. Topic: US and Western Economic  
and Political Leverage

Panel III:

The Honorable Robert S. Ellsworth  
Robert S. Ellsworth and Company  
Washington, D.C.

Professor Richard N. Cooper  
Department of International Economics  
Harvard University

The Honorable Myer Rashish  
Washington, D.C.

III. Topic: Implications for the  
Alliance

Panel IV:

Mr. Alexander Trowbridge  
President  
National Association of  
Manufacturers

Mr. Herbert Stein  
Senior Fellow  
American Enterprise Institute

Mr. Thadeus Dukes  
Executive Vice President  
Ingersoll-Rand

IV. Topic: Implications for US Business

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Briefing for the Senate Foreign  
Relations Committee -- 11 August 1982  
Office of Soviet Analysis, DDI

USSR: Economy in the 1980s, Dependence on the West  
and the Military-Economic Tradeoffs

- I. Mr. Chairman, you have asked for a briefing on three topics--prospects for Soviet economic growth in the 1980s, the degree of Soviet economic dependence--on the West in general and on the US in particular--and the vulnerability of Soviet military programs to Western use of economic measures.
  - A. I propose to discuss each of these questions in fairly summary fashion.
  - B. My colleagues and I, however, would be happy to try to answer questions you may have at any stage of my presentation.
- II. Let me turn first to the general economic prospects for the USSR, a subject that has attracted a great deal of attention both within the government and in the Western academic community and indeed in Soviet publications over the past several years.
  - A. There is general agreement on the Western side at least that Soviet economic growth will be markedly slower in the 1980s.
  - B. We believe that GNP growth is unlikely to average more than 2 percent per year in the 1980s, compared with 3 percent per year in the 1970s, and 5 percent per year in the 1960s.

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- C. In fact, the slowdown is already underway. Growth in Soviet GNP ranged from 1 to 2 percent in 1979, 1980, and 1981, and on the basis of first half 1982 results, we expect another year of growth below 2 percent.
- D. To repeat, then, we are projecting a period of very sluggish economic growth compared with what the USSR has experienced in the past. I want to emphasize, however, that it is not a prediction of economic collapse. Rather, it will be a period during which a new leadership will have to make increasingly tough choices among various programs--a subject I will return to later.
- III. A prolonged slowdown in GNP growth starting in the late 1970s had long been anticipated for a variety of reasons. Some the Soviets can do little about--notably the need to rely on costlier and more remote sources of energy and other raw materials and the declining increments to the labor force. Other factors tending to down the rate of economic growth in the 1980s reflect policy choices, especially the decision to restrain the increase in new fixed investment because of the continuing priority for defense.
- A. Turning to these sources of slower economic growth, I will begin with the energy situation.
1. With oil production sharply declining in the European USSR and having peaked at the giant Samotlor field in West Siberia, maintaining oil output has become increasingly costly and



difficult. Oil is still the USSR's major source of energy, accounting for over 40 percent of production.

2. The coal industry is also in trouble. Reflecting inadequate past investment, production of coal--which accounts for about a quarter of energy output--declined for three straight years. Also coal quality, particularly its energy content, continues to deteriorate.
3. Construction of nuclear power facilities is lagging behind schedule. Nuclear power now accounts for only 6 percent of electricity output.
4. Natural gas, currently providing a little more than a quarter of energy output, is a bright spot in the energy picture. Production has been increasing rapidly, at about 7 percent a year. On the basis of huge reserves in West Siberia, the USSR should be able to sustain that rate of advance, at least as long as plans for gas pipeline construction do not hit serious snags.
5. Because of the promising outlook for gas, the Soviet energy position is far from desperate. Nonetheless, growth in energy production in the 1980s is likely to average only slightly more than one percent a year.

B. Labor shortages are becoming more and more of a brake on the economy. The labor force, which grew by about 20

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million persons in the seventies, will increase by less than 10 million persons in the eighties. As a result, the average annual increase in the labor force will decline to 1/2 percent per year in the 1980s compared with 1-1/2 percent per year in the 1970s.

1. Moreover, the increment in the labor force will be very unevenly distributed geographically. The Russian Republic, for example, will show no net growth in the labor force while the Central Asia will account for 90 percent of the total national increment.
  2. The effect of the employment slowdown on the economy's performance could be substantial. More than any other industrial power, the USSR<sup>a</sup> has relied on increases in the size of the labor force to spur development.
- C. Meanwhile, slowing growth in investment will mean that the stock of plant and equipment will not rise as rapidly in the 1980s as in the past.
1. Investment in the first half of the 1980s is slated to rise by only about 10 percent over 1976-80--by far the lowest increase in the post World War II period.
  2. The slowdown is attributable in part to bottlenecks in sectors such as steel and construction materials that provide key investment inputs.

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3. It also can be explained by a leadership decision to maintain the primacy of defense spending--which continues to rise at about 4 percent a year--and to some increased attention to consumption.
4. The slowing of investment growth comes at a particularly inauspicious time since the amount of capital needed to produce a unit of output--especially in energy and raw materials--is sharply rising.

D. Turning now to Soviet economic ties with the West, the USSR was helped considerably in the seventies by a rapid rise in the price of its principal exports -- oil, gas, and gold -- and a willingness of Western lenders to support a large increase in the Soviet hard currency debt. The outlook for the eighties is not nearly so favorable.

1. Exports of oil, which now account for over half of hard currency earnings from merchandise exports, are likely to be greatly reduced by the leveling off of oil production and by increasing consumption at home. The loss of earnings from oil that we expect will be only partially offset by increased sales of natural gas under the new contracts with Western Europe.
2. We also think that because of production difficulties, unfriendly markets in the West, and rising domestic consumption, the USSR will do well

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to maintain the volume of its non-energy exports at the 1980 level.

-- While military sales are likely to increase, Soviet customers will have a harder time paying for them. We think a larger share will carry long repayments or barter terms.

3. Furthermore, Soviet terms of trade vis-a-vis the West probably will be far less favorable in the eighties than they were during much of the 1970s. The steep rises in oil prices--and in other raw materials sold by the USSR--that occurred during the 1970s seem unlikely to be repeated in the eighties.
4. As for Soviet imports, persistent weaknesses in the agricultural sector coupled with the leadership's commitment to improving the people's diet make it likely that the USSR will continue to spend heavily on grain and other farm products. These agricultural imports would have to come at the expense of non-agricultural imports.

E. The USSR's external economic situation promises to be strained also by the need to give aid to its client states. East European countries, in particular, face serious economic problems of their own and will presumably pressure the USSR to continue trading with them on more favorable terms than Moscow does with the West.

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1. Poland especially will probably continue to receive large infusions of aid.
2. The resource drain on the USSR from such subsidies and aid could thus remain heavy.

IV. Soviet leaders are well aware of their economic problems. Nevertheless, they express confidence--at least publicly--that all obstacles can be overcome by boosting productivity.

A. In fact, however, labor productivity has been rising more and more slowly and capital productivity has been declining for several years.

1. Some of the poor performance on the productivity front can be attributed to rising costs of extracting resources, whether in Siberia or more than 3 thousand feet down in a Ukrainian coal mine.
2. We also see abundant evidence of bottlenecks in industry and transportation that, together with shortfalls in agriculture, have kept industry working at less than capacity.
3. Part of the blame for production failures undoubtedly belongs to Soviet planners, who have made the wrong investment decisions in the steel, coal, construction materials, and machinery industries.
4. But much of the productivity slump remains a mystery to us and to the Soviet authorities themselves.
  - a. Soviet officials often cite the lack of labor discipline in the factory and on the farm.

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- b. Certainly, the rate of growth of incentives has tapered off as the rise in personal incomes has outstripped the availability of consumer goods and services.
  - c. It is also true that factory managers are less strict with their employees because of the increasing difficulty they are having in finding new workers.
  - d. Finally, we may be seeing the expression at the work place of a general disenchantment within Soviet society, a subject that has received a great deal of academic and popular attention in the West in recent years.
- B. In any event, we don't believe that the leadership can do anything in the next few years to turn the economic situation around.
- 1. Economic reform is often suggested as a remedy, and the Soviet themselves have devised numerous reforms in management and planning in the last several years.
  - 2. These measures do not seem to have had any impact on the efficiency of the economy. Instead, they have tended if anything to increase the degree of centralized control and intervention in enterprise management.

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3. The prospects for reforms that would truly loosen central control and move the economy toward greater reliance on prices and market forces are not bright at any time and seem especially dim during a succession period.
  4. We estimate--with no great confidence, however--that no serious economic reform involving decentralized decision making regarding production and investment choices will be tabled until a new leadership has managed to secure its position and the economic situation is substantially worse than it is now.
- V. I would like now to address the second topic -- Soviet dependence on the West.\* In a nutshell, we believe the Soviets could go it alone if denied all access to Western goods and services, but only with sizable losses in consumer well being and in the productivity and quality of industrial output.
- A. Imports paid for in hard currency are considerably more important to the USSR than the raw trade numbers imply.
1. Hard currency imports--which account for about two-fifths of total Soviet imports--are equal to as much as 5 percent of the ruble value of GNP.
  2. In addition, East-West economic ties have developed to the point that if Western technology and goods were not available to the USSR it could not adjust

\* We use the term "West" to refer to the USSR's trade with all hard currency non-Communist partners.

quickly or completely to their loss. Valuable time would be lost, in trying to adjust, adding substantial strains to an already stretched economy. This year, for example, with orders for Western machinery and equipment already sharply curtailed, further reductions in imports would impinge on priority programs in steel, transportation, agriculture, and heavy machine building.

3. But dependence really cannot be found in ratios of imports to GNP or other statistical measures. Dependence exists primarily in particular sectors and programs.

VI. First I want to look at the connection between equipment imports and the economy. Soviet leaders decided in the early and mid-1970s that access to Western technology could boost economic growth by stimulating productivity and helping to break critical production and construction bottlenecks.

- A. Although the USSR has had considerable difficulty in assimilating the equipment and technology it bought from the West, these imports have helped Moscow deal with some critical problems, particularly in certain manufacturing sectors. And, as I mentioned a few minutes ago, the Soviet Union stands little chance of keeping its economic growth up unless it can reverse the recent trends in labor productivity in industry,



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agriculture, and the economy in general. I would, therefore, like to point out a few of the areas in which Western technology has played a key role.

1. In the 1970s, imported chemical equipment accounted for about one-third of all Western machinery purchased by the Soviets.

a. This equipment was partially or largely responsible for doubling the output of ammonia, nitrogen fertilizer, and plastics and for tripling synthetic fiber production.

b. Western chemical equipment and technology will continue to be important for Soviet production of consumer goods and chemical-based industrial materials, for farm output, and for plans to overhaul a chemical industry that is still antiquated in many areas.

2. Right now, Soviet plans for a number of important programs have been delayed because construction equipment has not been available in sufficient variety or quantity to build plants.

a. Plans to produce heavy industrial tractors and bulldozers have been delayed by faulty tractor and engine designs.

b. The USSR also lacks the capacity for production of transmissions, suspension systems, and heavy-duty axles (capable of supporting weights of 50 tons or more).

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- c. The plan to produce their own equipment with imported plant and technology. [REDACTED]

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d. [REDACTED]

3. Large computer systems and minicomputers of Western origin also have been imported in large numbers (1,300 systems since 1972).

a. These have capabilities that the Soviets cannot match and use complex software that they have not developed.

b. Moreover, they often are backed up by expert training and support that the Soviets cannot duplicate elsewhere.

B. Meanwhile, imports of equipment from the West have played a vital part in supporting the energy sector.

1. Because of deficiencies in drilling, pumping, and pipeline construction, the USSR bought about \$5 billion worth of oil and gas equipment in the 1970s.

2. These purchases, covering a wide range of equipment, have added substantially to energy production.

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- a. Submersible pumps purchased from the United States, for example, are estimated to have added roughly 2 million b/d to oil production alone in recent years.
  - b. Practically all large diameter pipe laid in the USSR has been obtained from Western Europe or Japan.
  - c. US production technology recently installed will allow the USSR to produce drilling bits with a life expectancy 5 to 20 times greater than experienced with Soviet bits.
  - d. Similarly, the Soviet offshore exploration effort would not be nearly as far along as it is without access to Western equipment and know-how.
3. The USSR will continue to need imports of a broad range of Western oil and gas equipment if it is to minimize the fall of production in declining fields, increase output elsewhere, and help locate and develop reserves.
- C. Agricultural imports are the other major source of economic dependence on the West. Soviet purchases of Western grain jumped from an average of 17 million tons a year in 1976-78 to 27 million tons a year in 1979-80, and to 39 million tons in 1981.
1. Without Western grain, Soviet consumers would not have had the increase in meat consumption they have

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realized since the early 1970s, and there would have been a sharp drop in per capita consumption of meat in the late 1970s instead of a levelling off.\*

2. After three consecutive poor grain harvests--and with another below-trend crop expected this year--imports of grain will continue to be critical for the Soviet livestock sector and for consumption goals.
  - a. We now estimate the 1982 grain crop at 165 million tons, or more than 70 million tons below the Soviets' planned output.
  - b. We also believe that total grain imports will be close to the limit set by port and rail capacity--roughly 50 million tons a year--during the marketing year ending next June.

VII. Dependence on the West, however, does not translate into dependence on the United States. If US-Soviet economic relations were shut down, the Soviets, could--with few exceptions--switch to other Western and some East-European suppliers for products and technology.

- A. The Soviets need US grain mainly in years when stocks are low world-wide and grain crops in other major grain-exporting countries are poor.

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\* Imports of livestock products and other agricultural commodities used in livestock production accounted for two-fifths of available livestock products in the USSR in 1981. (U)

1. We believe, for example, that Moscow could buy most of the grain it needs this year and next from other suppliers, although it probably would have to pay premium prices for some of the purchases.
  2. The Soviet Union, however, probably could not find the mix of grain it would like without coming to the United States. Most observers agree that the USSR prefers to import wheat and corn in roughly equal proportions, and the United States is the world's major corn exporter.
- B. A continuation of the US embargo on sales of energy equipment would have a somewhat greater impact, especially in the short run.
1. The volume of water brought up with Soviet oil is getting larger, and a program to produce a good high-capacity submersible pump domestically has not yet been successful.
  2. US manufacturers now have a monopoly on producing high-quality, high-capacity pumps. If these remain embargoed, however, other Western suppliers could enter the field within about two years.
  3. Although the United States is the world's leader in the manufacture of drilling equipment, producers in Japan and Western Europe could eventually gear up to supply the Soviet market with products of comparable quality.

C. The US embargo on export of oil and gas goods and technology to the Soviet Union is already affecting the timetable of the Siberia-to-Western Europe gas export pipeline.

1. The USSR and its West European suppliers and customers are trying to decide how to reformulate the project in light of US sanctions.
2. Nevertheless, by using equipment available from Western Europe or Soviet equipment (or a combination of both), the Soviets will be able to commission the export pipeline and start pumping gas through it, by late 1984, although at a reduced flow. By using excess capacity in existing pipelines, they should be able to meet their gas delivery contracts until the export pipeline is completed.
3. To the extent that Soviet-made turbines and compressors must be diverted from domestic pipeline to the export pipeline, the domestic economy will lose some gas--as much as 30 billion cubic meters annually for a year or so in the mid-1980s.

VIII. Before turning to the question of Western ability to influence Soviet defense decisions through economic measures, let me then briefly summarize our assessment of overall Western leverage.

- A. The impact of Western denial of goods and technology to the USSR could range from minimal to substantial.

1. A unilateral US denial policy--whether focused on strategic technology, machinery, or grain--would--as I said earlier--have little impact. There are too many alternative sources of supply available to the Soviets.
  2. At the other extreme, the dislocations caused by a total Western embargo on trade with the Soviet Union with minimal circumvention probably would lead to a drop in Soviet GNP in the short term and slower economic growth in the long term. It would force even harder choices on the leadership with regard to domestic resource allocation decisions.
  3. I want to stress, however, that trade restrictions must be maintained for more than 2 or 3 years to be effective. It is the cumulative effects of prolonged denial that are important.
- B. Although the Western states, acting together, have the potential to impose severe economic costs on the USSR through a cessation of commercial and technical relations, their ability to gain political leverage is circumscribed by three factors:
1. First, the Soviet economy is large and self-sufficient enough to support the main thrust of its current military and foreign policies in spite of any embargo the West might implement.

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2. Second, Soviet leaders will be extremely reluctant to appear to be giving in to Western pressure. This would be particularly true of any new leader trying to establish his dominance.
3. Third, based on past experience, Soviet leaders probably do not expect that sanctions or embargoes will be rigorously imposed throughout the West or long lasting.

IX. Mr. Chairman, my final topic today will be the trade-off between economic growth and defense spending, with some discussion of Western influence in this area.

A. First I'd like to address the general economic and political pressures impacting on defense spending.

1. Then I will offer a few comments on Western leverage on the Soviet defense effort.
2. I wish to point out that I intend to discuss a wide range of Western options without regard to the likelihood of their implementation.

B. Because of the economic prospects that I described earlier, the conflict between the requirements of defense and the needs of the economy poses an ever sharper dilemma for Soviet leaders.

1. On the one hand, they believe that they are facing a more hostile international environment, which argues for a larger defense effort.
2. But the defense burden must seem harsher as growth in GNP declines.

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C. What will the USSR do? In the near term, we think it will maintain the priority accorded to defense in spite of mounting economic problems:

1.



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we expect that

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Soviet defense spending will continue to grow at about its historical rate of 4 percent a year through at least 1985.

2. In terms of specific changes in weapons programs in response to any US buildup, however, the USSR will probably seek to avoid making any hard choices until the shape of the US defense program becomes clearer.
3. It is important to note in this connection that the Soviets recognize that military power is their principal currency as an international actor. Considerable pressure exists, therefore, to continue high levels of defense investment to sustain Moscow's global role.
4. Further, given the current support within the Soviet elite for a strong military position, advocacy of cuts in military spending would involve formidable political risks within the Politburo. This would be particularly true during a succession period.



5. Finally, Moscow probably will continue to view arms control as an instrument to limit deployment of new US weapon systems requiring costly new programs to counter. While the Soviets may appear to be more conciliatory, this does not imply, however, a readiness to make major concessions at the negotiating table.

D. Sustaining these policies over the long term, however, could ultimately entail unacceptable political and economic costs--costs that will be increasingly apparent to a post-Brezhnev leadership as it struggles to prepare its next Five-Year Plan for the last half of the eighties.

1. By that time it may be evident that continued priority for defense spending at the expense of civilian investment would weaken the ability of the economy to sustain higher defense spending in the next decade and would increase Soviet dependence on Western technology and equipment for the most advanced industrial processes.
2. Already, some Soviets are questioning the wisdom of the planned slowdown in the growth of new fixed investment.
3. Moreover, if average annual growth in military outlays continues at 4 percent or higher, per capita consumption by mid-decade could well decline.

- E. Faced with these conditions, a new leadership will feel greater pressure to reduce the growth in military spending in order to free up the labor and capital resources urgently needed in key civilian sectors.
1. In this connection, the cost avoidance benefits of arms control agreements could assume greater importance in Soviet policy.
- F. Unfortunately, the choices that a new leadership will make cannot be predicted with any degree of confidence. It depends on the balance between Moscow's perception of the severity and duration of the economic slowdown and its assessment of the cost and risk of selective alterations in the military effort.
- G. Nonetheless, under these leaner circumstances a Western trade embargo would very likely force the Soviet leadership to reexamine some of the tradeoffs.
1. Soviet imports can be divided roughly among three categories:
    - imports of raw materials and industrial products that are needed by Soviet industry,
    - purchases of machinery and technology that support Soviet investment and modernization plans, and
    - imports of grain and agricultural products that serve consumer programs.

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2. If forced to cut back on imports, we don't think there is much room to reduce imports of raw materials and industrial products.

3. Soviet lenders would then have to choose between agricultural and machinery purchases.

--If they decided to cut back on grain imports, for example, in order to protect investment goals, increases in food consumption would have to be scaled back.

--As a result, living standards could begin to fall.

--Lower consumption levels in turn would increase popular dissatisfaction and hinder leadership attempts to raise productivity.

4. On the other hand, the investment crunch I mentioned will become increasingly tight during this decade. Should the leadership decide to maintain or even increase agricultural imports at the expense of machinery imports, investment and modernization would suffer, with long-term effects on both production and the level of Soviet technology.

H. But to return to the basic question that you asked-- there is little chance that Western economic sanctions, even if comprehensive and sustained, could markedly affect Soviet military power for the better part of a decade. Most of the weapons and forces on which Soviet power is based are already in the field or in production.

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1. First of all, major changes in defense allocations take time, and we expect current patterns to prevail for at least several more years.
2. The main impact of Western economic sanctions would be to slow qualitative improvements in Soviet weapon systems.
3. And, given the time required to develop a new or modify an existing weapon system substantially, a denial of Western technology would not have a major impact until the later 1980s. The maximum impact would be felt in the 1990s and beyond.
4. Should a weakening of the industrial base ultimately force some cuts in military programs, this would not happen quickly and the effects on overall Soviet military capabilities would be very gradual.